

Chapter 4

Member investment choice and the role of the trustee

4.1 A major issue considered by the committee during the inquiry was the extent to which superannuation savings are adequately safeguarded under the existing prudential framework, and whether potential risks to the safety of superannuation savings are adequately covered in the current regulatory environment. The committee strongly believes that ensuring the safety of retirement savings should be a fundamental objective of any pension or superannuation regulatory regime.

4.2 In this chapter and the next the committee examines a number of issues that collectively address the broad theme of safeguarding superannuation savings. Chapter 4 specifically addresses terms of reference 5 and 6: the meaning of member investment choice and the responsibility of the trustee. It does so mainly from the perspective of the prudential standards with which funds comply; specifically, trustees' fiduciary responsibilities under the SIS Act and the Australian Prudential Regulation Authority's (APRA) interpretation of the act and SIS regulations and the guidance it provides to trustees.

Member investment choice

What is member investment choice?

4.3 Under a system of member investment choice, superannuation funds enable members to choose from a range of investments in major asset classes, combinations of asset classes and investment options. A trustee may be instructed by a member to follow a particular investment strategy which involves investing funds in a specific financial product, such as a managed investment scheme.¹ The investment option relates to a choice of investment strategies rather than a choice of specific investments. Each strategy must comply with the investment strategy required by section 52(2)(f) of the SIS Act. If a member's fund does not provide the type of investment option the members wants, the affected member is able to move to another fund with more suitable investment options.

4.4 Member investment choice is not a new concept. For over a decade investment choice has been the norm for accumulation funds. One recent estimate suggested that 89 per cent of superannuation funds offer investment choice to fund members. According to the Investment and Financial Services Association (IFSA):

When combined with rapid technological advances and greater administrative efficiencies in the 1990s, member investment choice became part of the framework for the development and rapid growth of

1 It is important to note that a trustee cannot be bound by a direction from a member.

superannuation administration platforms that are offered mainly through licensed investment advisers.²

4.5 The number and types of choices, and how they are offered to members, have expanded over this period. Initially, funds offered limited choices of between three to five investment options. However, over time these options have become more sophisticated with funds offering their members as many as 50 or more investment options. APRA reported that as of June 2006 retail funds offered the greatest number of investment choices to members, with an average of 88 investment options per fund. This contrasts with industry funds that had an average of ten investment options per fund, and corporate and public sector funds that had an average of seven and six investment choices per fund respectively.³ Table 1 provides a breakdown of investment choices as reported by APRA.

4.6 Some in the industry believe the proliferation of investment options is the best way to improve service delivery to consumers. Some funds are 'adding value' to their investment products by diversifying their investment menus and providing niche investment options.⁴ The legislation, however, does not set any investment limits for funds of individual members.

Table 1: Investment choice by fund type as reported by APRA, year end June 2006⁵

Fund type	Corporate	Industry	Public sector	Retail	Total
Number of entities with more than four members	555	81	44	192	872
Number of entities offering investment choice	205	68	29	127	428
Proportion of entities offering investment choice	36.9%	84%	65.9%	66.1%	49.1%
Average number of investment choices offered per entity	6	10	7	88	35

2 IFSA, *Submission 60*, p. 20.

3 Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, June 2006 (issued 22 March 2007), p. 6.

4 Choice, *Submission 75*, p. 7.

5 Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, June 2006 (issued 22 March 2007), p. 37.

4.7 The industry recognises several distinct advantages in enabling fund members to choose their investment options. It enables them to better manage their investment approach and therefore minimise exposure to risk. It also enables members to move away from more conservative investment options that might provide low long-term average returns and give them a sense of ownership and control of their superannuation savings. Under member investment choice fund members bear the investment risk.

4.8 Evidence shows that fund members who do exercise choice are mainly high net worth individuals with large superannuation balances who are interested in their retirement savings.⁶ However, while the opportunity for member investment choice is widespread in Australia, the evidence shows that the majority of fund members do not seek or exercise investment choice. According to industry research, over 80 per cent of fund members do not actively choose either investment or insurance options.⁷ This figure increases to over 90 per cent for industry funds. In terms of total assets held by funds with more than four members, at 30 June 2006 48.8 per cent of assets (\$318.7 billion) were held in the default investment strategy.⁸

4.9 In the majority of cases where member choice is not exercised, the members' account is invested in a 'balanced' default option. This raises a series of interesting issues relating to the meaning of investment choice, why it is not being exercised by most fund members, and the relationship between choice and the provision of appropriate and affordable financial advice (see the discussion of this complex issue in Chapter 6).

4.10 Major industry bodies were cautious about the alleged benefits to members of funds offering unlimited investment choices. According to the Association of Superannuation Funds of Australia (ASFA):

In the absence of involvement of financial planners there are actually grounds for believing that the more investment choices that are available, the less likely a member is to actively exercise a choice. Research into consumer behaviour indicates that more choice above a certain level can lead to greater confusion and uncertainty, and this applies whether it is types of jam or coffee, or investment options within a superannuation fund.⁹

4.11 The ASIC submission pointed out that member investment choice triggers certain disclosure obligations under the Corporations Act that were introduced by the financial services reforms (FSR) to apply in addition to the specific SIS Act disclosure requirements. From 1 July 2007, the disclosure requirements have been modified

6 Mr David Elia, Chief Executive Officer, HostPlus, *Committee Hansard*, 6 March 2007, Melbourne, p. 62.

7 SuperRatings, *Submission 49*, p. 6.

8 Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, June 2006 (issued 22 March 2007), p. 6.

9 ASFA, *Submission 68*, p. 23.

modified to enable trustees to prepare product information about a specific financial product. This stands in contrast with the current arrangement whereby trustees are required to provide members with a product disclosure statement prepared by the issuer of the financial product.¹⁰

4.12 The committee notes that the superannuation industry is fully supportive of member investment choice. There does not appear to be support for mandating a default strategy for certain elements of retirement savings. The Financial Planning Association submission argued that mandating a default strategy would be counter-productive to enabling people to achieve their retirement saving goals.

4.13 Yet the committee finds that notwithstanding the advent of member investment choice, default investment options remain a critical component of the compulsory superannuation system. This is one of the main reasons why the role of trustees is critical to the long-term viability of the superannuation system.

4.14 APRA statistics show that, with respect to major superannuation funds, the proportion of total superannuation assets in the default investment strategy was 54.8 per cent in June 2006, although this is trending down. This means that less than half of all superannuation assets in major funds are invested on the basis of members exercising an alternative investment choice strategy.¹¹

4.15 In the industry fund sector for example, where 99.2 per cent of assets are in entities offering investment choice, at an average of 9 options per entity, a higher than average 73.6 per cent of assets remain in the default setting. Alternatively, while a smaller proportion of retail fund sector assets are in entities offering investment choice (87.5 per cent), entities that do offer investment choices provide an average of 108 options. In this sector a smaller proportion of assets (42.4 per cent) remain in the default strategy.¹²

4.16 APRA's complete statistics on investment choice by sector and up to June 2006 are included in Appendix 5. Statistics presenting a breakdown of the asset allocation of default investment strategies by sector are also included in Appendix 5.

10 ASIC, *Submission 48*, p. 14. The revised arrangements to take effect from 1 July 2007 are set out detail in ASIC Policy Statement 184, *Superannuation: Delivery of product disclosure strategies*.

11 APRA, *Insight*, 'Celebrating 10 years of superannuation data collection', Issue 2 2007, Table 13, pp. 55-56. Figures are for entities with at least \$100 million in assets. The distinction between those who consciously decide to remain in the default setting and those who remain so because of disinterestedness in their investment strategy is not captured in the statistics.

12 APRA, *Insight*, 'Celebrating 10 years of superannuation data collection', Issue 2 2007, Table 13, pp. 55-56. Statistics for retail funds do not include eligible rollover funds, which do not offer investment choice.

The role of the trustee

4.17 The SIS Act includes provisions that deal with the prudent investment of superannuation assets. Members of superannuation funds face a number of investment risks; for example, the trustee failing to formulate an appropriate investment strategy, give due attention to diversification and comply with well-founded investment strategies. To address these risks, trustees are required to ensure that each investment option meets the requirements of the investment covenant at subsection 52(2)(f) of the SIS Act. The covenant requires the trustee:

(f) to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following:

- (i) the risk involved in making, holding and realising, the likely return from, the entity's investments having regard to its objectives and its expected cash flow requirements;
- (ii) the composition of the entity's investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification;
- (iii) the liquidity of the entity's investments having regard to its expected cash flow requirements; and
- (iv) the ability of the entity to discharge its existing and prospective liabilities...¹³

4.18 The trustee must also meet certain requirements under SIS Regulation r.4.02 when offering investment strategies in order to be protected under section 55(5) of the SIS Act against action by any members in relation to investment losses. These requirements include that the trustee must give members:

- the investment objectives of each of the offered strategies;
- information the trustee reasonably believes necessary for the member, or class of members, to understand the effect of, and any risk involved in, each of those strategies; and
- the range of directions that can be given to the trustee of their fund and the circumstances in which these directions can be changed.¹⁴

4.19 In respect of investment decisions, the SIS Act does not specify how trustees must give effect to the covenant. However, the Productivity Commission found that the act mostly codifies what a prudent trustee could be expected to do under general trust law. The Commission also found that the investment covenant may strengthen prudent management because it:

13 *Superannuation Industry (Supervision) Act 1993*, subsection 52(2)(f).

14 Australian Institute of Superannuation Trustees, *Submission 79*, p. 21.

- provides the trustee with a clear statement of responsibilities which may assist their efficiency, because the 'tasks' have been spelt out;
- provides greater assurance that an appropriate investment strategy is formulated, implemented and reviewed; and
- provides greater transparency and certainty with respect to what must be done by a trustee.¹⁵

4.20 APRA's submission stated clearly that in offering investment choice to members, trustees must balance the objective of providing choice while ensuring they invest fund assets in a prudent and responsible manner in order to manage and minimise risk:

...APRA does expect trustees to take responsibility for mitigating particular risks such as concentration risks and demonstrate that they have done so on an ongoing basis. In its prudential reviews, APRA seeks to understand how trustees have assessed such risks and addressed them in an acceptable manner.¹⁶

4.21 In March 2006 APRA issued a revised circular that provides trustees with guidance on how to discharge their duties as required by the SIS Act. Superannuation Circular II.D.1, *Managing Investments and Investment Choice*, explains the requirements of the SIS Act for managing investments and investment choice in APRA-regulated superannuation entities and, importantly, provides guidance to trustees on how APRA approaches its supervisory role in relation to these and some other investment-related matters.¹⁷ It is the intersection of these two aims, in particular how the former has come to inform the latter, which has resulted in much confusion and concern within the superannuation industry over APRA's guidance (see the discussion from paragraphs 4.25 below).

4.22 According to the circular:

Under the SIS Act, the trustee of a superannuation entity is solely responsible and directly accountable for the prudential management of the investment of the entity's assets. It is the trustee's duty to make, implement and document decisions about investing those assets and to carefully monitor their performance.¹⁸

15 Productivity Commission, *Review of the Superannuation Industry (Supervision) Act 1993 and Certain other Superannuation Legislation*, Report No.18, 10 December 2001, p. 127.

16 APRA, *Submission 51*, p. 8.

17 Australian Prudential Regulation Authority, *Superannuation Circular No. II.D.1: Managing Investments and Investment Choice*, March 2006. This updated version replaced an earlier superannuation circular on investment choice dated April 1999.

18 Australian Prudential Regulation Authority, *Superannuation Circular No. II.D.1: Managing Investments and Investment Choice*, March 2006, p. 4.

4.23 APRA stated that the guidance provided in the circular is not intended to significantly impinge on the choices that trustees can offer and members make: 'Rather, it focuses on trustee protection of members' interests by means of sound processes and policies to manage investment risk'. The circular goes on to state at paragraphs 38 and 39 that:

Trustees of APRA-regulated funds that offer investment choice are expected to:

- Recognise their statutory responsibility to set each investment strategy offered by the fund;
- Consider the circumstances of the fund when formulating each investment strategy;
- Ensure that appropriate controls are in place to manage risk, diversification and liquidity; and
- Recognise that if it fails to fulfil its obligations, it leaves itself open to loss of the statutory defence available under s. 5595 of the SIS Act against claims for the investment losses.¹⁹

4.24 Notwithstanding APRA's guidance on member investment choice, opinions in the industry vary on the role of trustees in a member investment choice situation. There does, however, appear to be agreement that the trustee's role is primarily twofold: to facilitate the selection of investments by a member through provision of a 'menu' of investment option and make a default selection in circumstances where the member has either not provided investment instructions or is unable to do so. One of the key issues for trustees is managing investment risk for members.

Criticism of APRA's interpretation of investment choice

4.25 The need for regulatory clarity regarding the role of superannuation trustees was a consistent theme in evidence before the committee. This emerged as a key issue as a result of ambiguity in the interpretation of the trustee's obligations and members' responsibilities. There is, at least in theory, a dichotomy in the regulatory environment between permitting member choice of investment (with or without financial advice) and the requirement that the trustee must adopt an investment strategy for the fund as a whole. The issue was stated clearly by the Industry Funds Forum (IFF) submission:

This dichotomy creates a conflict between the trustee's obligation to determine and accept total responsibility for the investment strategy, while at the same time allowing that strategy to permit members to direct the trustee how they wish to invest. APRA's interpretation in the Circular of how these two concepts interact is proving unworkable for some trustees of funds offering a wide range of investment choices.²⁰

19 Australian Prudential Regulation Authority, *Superannuation Circular No. II.D.1: Managing Investments and Investment Choice*, March 2006, p. 11.

20 IFF, *Submission 73*, p. 24.

4.26 Some submitters noted the potential for conflict between the need for trustees to maintain a responsible investment strategy and the impetus to provide investment choice. The issue was described clearly in evidence by Mercer Human Resource Consulting:

We are in a choice environment. Members can choose their own fund. It seems anomalous that, whilst a member can choose his own fund, he cannot choose his own investment. In many cases, members have chosen a particular investment strategy on the advice of their own financial planner; yet here we have APRA saying it is inappropriate for that advice to be followed in a superannuation fund.²¹

4.27 Furthermore, some witnesses pointed out that conflict may arise when the investment choice facility is so broad it risks undermining the benefits of collective investment. As pointed out by the Corporation Superannuation Association:

...there are concerns that if enough members...adopt a particular specialised approach involving a narrow class of shares, this could put the savings of other fund members at risk because of the requirement that the trustee re-balance the portfolio thereby reducing the exposure of the other members to the class of stocks specifically chosen by the narrow investment choice members.²²

4.28 The tension between APRA and sections of the industry has centred on different interpretations of the law; specifically, over sections 52(4) and 52(2)(f) of the SIS Act. This tension is at the heart of debate over the regulation of member investment choice. For many within the industry APRA's circular has clouded the issue and fuelled concerns about the role of the trustee in formulating investment strategies especially where, as previously noted, members have received advice from a financial planner. There is a strongly held view within the industry that APRA's interpretation of the law extends the trustee's responsibility to the investment choices made by members on the one hand, yet ignores the availability of financial advice in a member investment choice situation on the other.²³ According to the IFSA submission:

While there is much in the APRA circular with which the industry would agree, the critical differences revolve around an interpretation of the law that would effectively extend trustee responsibility to individual member investment choice and ignore the availability of financial advice in member investment choice.²⁴

21 Mr John Ward, Principal and Manager, Mercer Human Resource Consulting, *Committee Hansard*, 25 October 2007, Melbourne, pp. 67-68.

22 Corporate Superannuation Association, *Submission 28*, p. 10.

23 MLC, *Submission 83*, p. 11.

24 IFSA, *Submission 60*, p. 22.

4.29 The IFSA submission argued further that APRA's views, as set out in the circular, are a departure from how the industry has come to interpret the relevant SIS provisions and have placed significantly more responsibility on trustees over and above the responsibility to offer and manage suitable investment strategies for members. Limitations placed on the investment choices made by members may result in regulated superannuation funds being at a competitive disadvantage to self-managed superannuation funds (SMSF) where there are no investment choice restrictions: 'As a result...some clients will transfer to a SMSF to create the flexibility they need to avoid what they and their advisers will perceive to be limited investment choice within a fund...'²⁵

4.30 The Financial Planning Association of Australia (FPA) submission made a similar argument in noting the difficulty arising from APRA's view that trustees are generally unable to take into account individual advice provided to a member by a financial planner when developing an investment strategy for a fund. The advice from the financial planner may take into account the individual needs of the member including any other superannuation assets and the member's general retirement objectives:

In the view of the FPA, this has the capacity to limit the operation of the government policy as embodied in Superannuation Choice and discourage members from taking an active interest in their financial future.²⁶

4.31 Submissions from the Australian Bankers' Association (ABA) and the Law Council of Australia noted conflicting views within the superannuation industry about whether the trustee is restricted to offering investment strategies consistent with section 52(2)(f), or whether the trustee can accept directions relating to investment choices irrespective of the funds' investment strategies. The ABA stated emphatically:

We are concerned that the interpretation of the law as contained in the circular would in effect extend trustees' obligations to individual members' investment choice. The formulation of the investment strategy(ies) for the superannuation fund is the responsibility of the trustee; however, under a member investment choice regime the selection of investments within a strategy is the responsibility of the member. Superannuation is a personal investment and therefore investment choice is the member's responsibility.²⁷

4.32 Whatever the interpretation, evidence from the Law Council expanded on ABA's concerns, highlighting a number of inconsistencies with the advice contained in APRA's circular.²⁸ The Council suggested that APRA probably does not have a firm grasp of the law as it relates to the role of the trustee in a member investment

25 IFSA, *Submission 60*, p. 21.

26 FPA, *Submission 38*, p. 10.

27 ABA, *Submission 88*, p. 15.

28 Law Council of Australia, *Submission 76*, pp. 4-6.

choice situation. It suggested further in evidence before the committee that the legal advice underpinning APRA's interpretation of the law should be made available and subject to review:

It would seem to us that APRA has said... 'Look, we've got legal advice. This is what it says.' I think the first good thing would be to have that legal advice subject to review then, from that, have a better dialogue with APRA, based on them having a firm understanding of what the law really is. It is probably just a bit of a genuine misunderstanding on their part as to what the law is in this case. I am not sure we need to go to a stage of direction from the government yet. But certainly this does need to be subject to review.²⁹

4.33 A number of other submitters shared the concerns of the ABA and the Law Council, noting that APRA's interpretation of the SIS Act effectively undermines the member investment choice arrangements that many public offer superannuation funds provide for their members. The AXA submission, for example, provided a clear statement of the issue:

One problem with the current regulatory environment is that the SIS Act explicitly recognises member investment choice, but APRA still expects the trustee to second guess a member's investment choices and to intervene in circumstances where the trustee does not believe the member's investment choice is prudent.

...the tension between the trustee's obligations to protect the individual member's interests in relation to his/her investment selection and the member's right to select investments which he/she believes best suit his/her personal financial circumstances still exists.

The view of Treasury and APRA

4.34 Senior officials from Treasury told the committee that although Treasury was 'very comfortable' with APRA's revised circular and with the regulator's interpretation of policy, it was aware of tension in the superannuation sector created by an environment where members have choice of investment, and trustees have an obligation to ensure the prudential viability of the superannuation entity as a whole. Treasury drew two conclusions from this assessment. First, there is a constraint on member choice to the extent that the range of investment options offered to members by a fund is not unlimited. Member investment choice, in other words, is not unfettered choice. The trustee must only offer a suite of options that is appropriate for that fund in terms of the trustee's obligations under the SIS legislation. Members must then choose from that suite of options. Second, trustees cannot abrogate their responsibility under the SIS legislation to a financial planner on the basis that the financial planner knows the customer better. This is because:

29 Mr Terry Brigden, Member, Superannuation Committee, Law Council of Australia, *Committee Hansard*, 7 March 2007, Sydney, p. 60.

...the SI(S) Act requires [the trustee] to know the fund and the entity. It does not mean that the financial planner cannot be a very helpful source of advice to the individual member in choosing between funds and the like, but the trustee has an obligation that comes before that.³⁰

4.35 However, when questioned further about conflict between a member receiving personal advice on how to invest money within a fund and trustee obligations under SIS, Treasury acknowledged the point but denied there was an 'inherent tension' in member investment choice arrangements:

The trustees have to have an eye to their overall membership. The demographics of the membership of one fund may differ from another. There are a range of choices and they differ...The advice to someone may be that, while they cannot get what they need from this fund because of other people who are part of it and the basic structure and risk structure of that fund, they would be better off going to someone else because it suits their circumstances better. That seems entirely reasonable and it still ensures that the trustee is meeting their obligations to the fund as a whole.³¹

4.36 The evidence provided by APRA conveyed essentially the same message. The APRA submission reiterated the view that the SIS Act requires that the trustee must properly develop each investment strategy offered and provide the necessary information about them, in accordance with the SIS Act and regulations. Further, trustees cannot abrogate responsibility in relation to investment strategies by requiring members to seek their own financial advice.³²

4.37 APRA's guidance states that there is no conflict between the trustees' obligation to determine how fund assets are invested on the one hand, and allowing a member to direct the trustee on specific investments on the other:

The underlying policy intent is that the provision of member choice of investment strategy does not remove the need for the trustee to ensure that the investment strategy or strategies of the fund comply with the requirements set out in the legislation.³³

4.38 At a hearing in Sydney on 7 March 2007, APRA provided a clear statement on the relationship between the role of the trustee in formulating investment strategies, the role of financial planning advice in a member investment choice situation and the constraints imposed on a trustee that in effect restrict the range of investment choices available to members:

30 Mr Chris Legg, General Manager, Financial System Division, Treasury, *Committee Hansard*, Canberra, 20 November 2006, p. 10.

31 Mr Chris Legg, General Manager, Financial System Division, Treasury, *Committee Hansard*, Canberra, 20 November 2006, p. 10.

32 APRA, *Submission 51*, p. 7.

33 Australian Prudential Regulation Authority, *Superannuation Circular No. II.D.1: Managing Investments and Investment Choice*, March 2006, p. 4.

Whilst the SI(S) Act does not prevent expressly a trustee from considering financial planning advice, a trustee must consider all the circumstances that an entity considers when formulating and implementing an investment strategy. Consequently, our approach has been to take the view that the extent to which a trustee takes financial planning advice would be incidental. We also note that the trustee does not have the ability to take into account the circumstances outside the fund itself.

In summary we see the separate role of financial planner as providing advice to individual members about the allocation of the member's interests in the fund between the choices offered by the trustee and within the parameters set independently by the trustee.³⁴

Is there a need for regulatory change?

4.39 The main message to emerge from the financial planning industry and peak superannuation associations is the need for regulatory change to clarify the operation of sections 52(4) and 52(2)(f) of the SIS Act. This would also require that further changes be made to APRA's circular on member investment choice. The submission from ASFA couched its main suggestion in very general terms: that the government consult with the superannuation sector to ensure a better integration between member investment choice and the current SIS obligations. Some concrete proposals from other organisations fleshed out the suggestion made by ASFA.

4.40 Two specific areas in need of change were identified. The first related to amending the SIS Act to clarify the duties of trustees of superannuation funds offering member investment choice. One proposal made by AXA is that section 52(4) of the SIS Act be modified: '...to make it clear that where an individual member provides a direction under this section the trustee does not have a responsibility to ensure that the selected investments are suitable to the individual member's financial circumstances and objectives'.³⁵ It argued that such an amendment would make it clear that the trustee's obligations do not extend to consideration of a member's financial circumstances.

4.41 Submissions from the FPA and Promina Financial Services recommended regulatory change to ensure that a trustee take into account any professional financial advice provided to members in respect of their superannuation. This follows from the concern that individual advice to a member from a financial planner need not be taken into account by the trustee.³⁶ The FPA argued that this situation not only has the capacity to limit the operation of government policy as embodied in Choice of Fund legislation, but also discourage members from taking an active interest in their financial future.

34 Mr Ross Jones, Deputy Chairman, APRA, *Committee Hansard*, 7 March 2007, Sydney, p. 93.

35 AXA Asia Pacific Holdings, *Submission 45*, p. 10.

36 FPA, *Submission 38*, p. 10; Promina Financial Services, *Submission 37*, p. 8.

4.42 The IFSA submission recommended that the SIS Act be amended to recognise the role of advice in superannuation and limit the duties of trustees to three distinct functions: formulating and documenting investment strategies, managing investments selected by members in a prudent manner, and reporting to members on those investments.³⁷

4.43 The submission from Mercer Human Resource Consulting argued that APRA's approach is akin to a trustee being able to provide financial product advice to members without knowing the financial circumstances of members. It suggested that APRA's circular should be revised to recognise the reality that it is totally impractical for trustees to be aware of the total financial circumstances of members and any investment choice made by a member under member investment choice is ultimately the member's decision.³⁸

4.44 The second area of change follows directly from the first and involves amending APRA's guidance to trustees. At the very minimum, it appears there is support within the industry for further discussion and review of APRA's approach as outlined in its circular.³⁹

4.45 The Corporate Super Association submission proposed an amendment to section 52(2)(f) to address the potential for conflict between the need for trustees to maintain a responsible investment strategy and to provide investment choice. In circumstances where enough members specialise and invest in a narrow class of shares, the amendment would involve: '...specifying a sub-strategy within the overall strategy which relates to the narrow investment choice [of] members and which acknowledges that their liquidity and other requirements under s 52(2)(f) fall into a sub-class'. The Association argued that '...this is the only rational way in which the difficulties can, theoretically, be managed'.⁴⁰

4.46 The committee notes that not all stakeholders expressed concern over the current regulatory framework relating to member investment choice. The Australian Institute of Superannuation Trustees (AIST) submission argued that the current framework, including APRA's guidance, is adequate, appropriate and practical for trustees to implement. The submission emphasised that in formulating an investment strategy, the trustee obtains professional advice from a number of sources, including its custodian, asset consultants, investment advisers, investment managers and other specialist in-house advisers, which is considered by the trustee at a board meeting.⁴¹

37 IFSA, *Submission 60*, p. 7.

38 Mercer Human Resource Consulting, *Submission 71*, pp. 12-13.

39 IFF, *Submission 73*, p. 22; REST Superannuation, *Submission 54*, p. 6.

40 Corporate Superannuation Association, *Submission 28*, p. 10.

41 Australian Institute of Superannuation Trustees, *Submission 79*, p. 22.

4.47 In a supplementary submission, IFF rejected the FPA's recommendation that a trustee be required to take into account any professional financial advice provided to members as misconceived and inconsistent with the responsibilities of a trustee:

There is no basis on which a superannuation fund could take account of the individual situation of a member. Nor can it take account of any financial advice that member may have been given. A trustee has an obligation to manage the fund and its investment strategies for all members of the fund as a whole.

A member is free to seek financial advice and is encouraged by most funds to do so, when selecting an investment option.⁴²

4.48 The AIST submission also argued that while it is up to funds to offer a range of appropriate choices within which members may choose their individual investment options, a trustee is entitled to rely on a member's investment choice at face value: 'A Trustee should not be required to go behind that member instruction and consider whether it was appropriate or not for that member'.⁴³

4.49 The view that investment choice does not provide members with an unlimited range of investment options to choose from was shared by the Recruiting and Consulting Services Association (RCSA) and Professional Associations Superannuation Limited (PASL) submission. It noted that although the common law and statutory duties of trustees may prevent some members from investing in the investment of their choice, there are alternatives:

The fact that the trustee may not be able to provide all the investments that are available is not a major barrier to choice. Where a member wishes to invest their superannuation contributions in a discrete asset or volatile asset class that is not provided by any regulated fund, we believe that the member should be advised to pursue their investment preference through the use of a Self managed Fund (SMF).⁴⁴

Committee view

4.50 The committee accepts that member investment choice and the responsibility of the trustee in this process have been handled well by the majority of trustees. The overwhelming majority of major funds have benefited from diversified investment options adopted in the medium term by fund managers.⁴⁵ Ultimately, the main safeguard is that each investment option is approved by the trustee. The only danger then is if the balance between options becomes a problem. However, there is no sign of this in the industry and it is unlikely to occur because the default option is likely to continue to prevail.

42 IFF, *Submission 73a*, p. 7.

43 IFF, *Submission 73a*, p. 23.

44 RCSA and PASL, *Submission 56*, p. 9.

45 SuperRatings, *Submission 49*, p. 7.

4.51 The committee believes that the trustee's responsibility in a member investment choice situation should be to its core statutory duties, including to act in the best interests of all members, implement the fund's investment strategy in accordance with the SIS Act and ensure proper disclosure. However, the committee accepts that this issue has given rise to different interpretations over matters of law and policy. While any investment choice made by a member under member investment choice is ultimately the member's decision, the dividing line between the trustee's and member's responsibility may be legally unclear.

4.52 The committee accepts the widely held view that trustees should not be responsible for the investment choices made by individual members, as such. In other words, trustees should not be unilaterally interfering with member selections or supervising individual statements under investment choice. As long as the trustee's obligations under the SIS Act are met, individual members should be able to make their own investment decisions without any further intervention by the trustee. If trustees were to override investment decisions made by members as a result of receiving professional financial advice, a number of important questions would need to be answered: what training and resources would trustees need and at what additional cost to members? How would trustees communicate a decision to override investment choices to the member? What further licensing is required to regulate this quasi-personal advice role?

4.53 APRA's circular has been interpreted by some within the industry as imposing on trustees a duty to inquire into and monitor each member's investment choice. The committee believes that this is not the intent of APRA's directive and, anyway, would be both unworkable and inconsistent with the trustee's duty to act in the collective interest of members. The committee acknowledges that while APRA made a concerted effort to consult with industry over its revised circular, it has not been able to allay concerns within the industry over its interpretation of the law. The committee is concerned by the continuing level of confusion over differing interpretations of the trustee's responsibility in a member investment choice situation. There is a concern that APRA's interpretation may prevent trustees from offering real investment choice to those members who want it. This, however, has to be balanced by the sound view put to the committee by APRA and Treasury that member choice is not unlimited choice: trustees are not permitted to allow an individual member's investment choice if that choice would not be suitable for the fund as a whole.

4.54 The committee is sympathetic to the widely held view that APRA's guidance does not provide the clarity which is much sought after by the industry. APRA's written advice appears to have created uncertainty for some trustees and their advisers, not less. The main issue raised in evidence is that trustees cannot be expected to take into account the overall financial circumstances of individuals or whether they have received independent financial or investment advice. Some stakeholders are concerned that APRA's approach is inconsistent with the principle of investment choice and even with community expectations to be able to exercise freedom of investment choice.

4.55 The committee finds that the main problem with the interpretation of member investment choice lies deeper than APRA's guidance to trustees. The growing need for financial advice and its importance to the financial well-being of fund members, which has been recognised for some time by the government, has created major policy challenges for the industry, the parliament and for regulators. Some witnesses pointed to the fact that the SIS Act pre-dated the advent of the Choice of Fund initiative and member investment choice. This means the SIS legislation does not refer specifically to financial advice. When SIS was introduced the common approach was a 'one size fits all' investment strategy for all members who had little input into how their retirement savings should be invested. Generally speaking, the need for advice did not then exist to any degree because the investments made by funds tended to be simple, uncomplicated and fairly predictable.⁴⁶ (The complex relationship which has since developed between member investment choice and financial advice is examined in detail in Chapters 6 and 7.)

4.56 It appears that industry concerns with APRA's interpretation of member investment choice and the legal advice upon which it is based have arisen because of an underlying systemic problem – the legislation has not kept pace with industry developments, government policy or even community standards. The committee believes this is the root of the problem. The committee does not conclude that member investment choice is unsustainable in the current regulatory environment. The committee believes strongly that APRA and trustees can continue to work together on this issue within the confines of the SIS Act. The industry's acceptance of the philosophy underpinning member investment choice provides the solid policy platform on which differences of opinion can be resolved.

4.57 There is a strong case for APRA further clarifying the trustees' specific obligations under the SIS Act in order to better accommodate the existence of member investment choice.⁴⁷ This is why the committee urges APRA to make available its legal advice on the role of trustees in a member investment choice situation, as a starting point for further industry consultation over the wording of its superannuation circular.

Recommendation 9

4.58 The committee recommends that APRA make available for public scrutiny any legal advice it has received on the role of the trustee in a member investment choice situation, as a starting point for further industry consultation to clarify the duties of trustees of funds that offer member investment choice.

46 Mr Richard Gilbert, Chief Executive Officer, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 94.

47 ASFA, *Submission 68*, p. 26.

Recommendation 10

4.59 The committee recommends that APRA, in consultation with the superannuation industry, review Superannuation Circular II.D.1 to clarify its interpretation of the role of the trustee in a member investment choice situation. The committee further recommends that APRA ensure that its written guidance better integrate the reality of investment choice and the obligations of trustees under the SIS Act.

Recommendation 11

4.60 The committee recommends that superannuation funds be permitted as part of reform to the disclosure regime to provide simple, standard advice to members at their request about the appropriateness or otherwise of non-standard default investment options within the fund.

